

CHAPTER 1

ACCOUNTING SYSTEM – ACCOUNTING PROCESSES

SCOPE

This chapter provides a foundation for basic accounting entries necessary to support certain financial transactions and reports. Examples are included to assist staff making various journal entries in order that these entries comply with Generally Accepted Accounting Principles (GAAP). Certain ENCOMPASS modules required to be in use by March 3, 2008, will move the State's accounting records a step closer to compliance with GAAP. As further modules are required, this chapter will be updated to include further information. A complete explanation of all ENCOMPASS chartfields and uses is included in the COA Handbook at <https://myshare.in.gov/sba/encompass>.

1.1 STATUTORY AUTHORITY

1.1.1	State Board of Accounts	3
1.1.2	Auditor of State.....	3

1.2 ACCOUNTING THEORY

1.2.1	Definitions of Accounting Financial Statement Classifications.....	3
1.2.2	Fund Types.....	4
1.2.3	Double entry accounting	4

1.3 ENCOMPASS FINANCIAL SYSTEM

1.3.1	ENCOMPASS Chartfield Structure.....	5
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1.4 ACCOUNTING ENTRIES

5.4.1	Agency to Agency Sharing of Expenditures.....	7
5.4.2	Allocation of Expense to Federal Fund (within agency).....	7
5.4.3	Passing Federal Dollars to Sub-recipient – Sub-recipient is Another State Agency or Another Federal Program.....	7
5.4.4	Passing Federal Dollars to Outside Sub-recipient	8

1.4.5	<i>Payments to Fiduciary Funds/Quasi-Agencies/Component Units from Governmental Funds..</i>	8
1.4.7	<i>PEN Products Purchases</i>	9
1.4.9	<i>Movement of state funds to federal funds</i>	9

1.5 APPENDICES

1.5.1	<i>Account Number Listing.....</i>	10
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1.1 STATUTORY AUTHORITY

1.1.1 State Board of Accounts

IC 5-11-1-2, System of accounting and reporting, states in (a): “The state board of accounts shall formulate, prescribe, and install a system of accounting and reporting in conformity with this chapter, which must comply with the following: (1) Be uniform for every public office and every public account of the same class and contain written standards that an entity that is subject to audit must observe. (2) Exhibit true accounts and detailed statements of funds collected, received, obligated, and expended for or on account of the public for any and every purpose whatever, and by all public officers, employees, or other individuals. (3) Show the receipt, use, and disposition of all public property and the income, if any, derived from the property. (4) Show all sources of public income and the amounts due and received from each source. (5) Show all receipts, vouchers, contracts, obligations, and other documents kept, or that may be required to be kept, to prove the validity of every transaction. The state board of accounts shall formulate or approve all statements and reports necessary for the internal administration of the office to which the statements and reports pertain. The state board of accounts shall approve all reports that are published or that are required to be filed in the office of state examiner. The state board of accounts shall from time to time make and enforce changes in the system and forms of accounting and reporting as necessary to conform to law.”

1.1.2 Auditor of State

IC 4-7-1-2, Powers and duties, states: “The auditor of state shall do the following: (1) Keep and state all accounts between the state of Indiana and the United States, any state or territory, or any individual or public officer of this state indebted to the state or entrusted with the collection, disbursement, or management of any money, funds, or interest arising therefrom, belonging to the state, of every character and description whatsoever, when the money, funds, or interest is derivable from or payable into the state treasury.”

1.2 ACCOUNTING THEORY

The State of Indiana Comprehensive Annual Financial Report (CAFR), as well as other reports, must be prepared in accordance with Generally Accepted Accounting Principles (GAAP), Financial Accounting Standards Board (FASB) statements, and Governmental Accounting Standards Board (GASB) statements. Currently, since not all ENCOMPASS modules are required, the State of Indiana financial records are, for the most part, maintained on a cash basis. Certain adjusting entries are made by the Auditor of State (AOS) staff in order to compile the CAFR. As more ENCOMPASS modules are required, the State will move toward a full accrual system, which will enable financial statements to be produced more timely and more accurate.

1.2.1 Definitions of Accounting Financial Statement Classifications

Brief definitions of certain accounting terms are included in this section as an aid to a better understanding of certain entries into ENCOMPASS. As we move toward a full accrual system, updates will include additional explanations as deemed necessary.

- Asset – the financial value (economic benefit) of what is obtained (owned) or controlled (owed to) by a particular entity (the State of Indiana, in our case). Assets would include, but are not limited to, Cash, Accounts, Grants & Loans Receivable (owed to), Capital Assets (owned). Asset account numbers begin with “1”.
- Liability – future sacrifices of Assets; i.e. what is owed and, in all probability, will be paid to outside vendors, other governments, etc. This does not include encumbrances; a liability does not exist until the goods or services have been received. Liability account numbers begin with “2”.
- Net Assets – total Assets less total Liabilities; in other words, the net worth of the entity. Net Asset (and fund balance) account numbers begin with a “3”.
- Revenue – revenue is created when a receivable is entered. If revenue is received with no prior receivable, the matching entry is Cash. Revenue account numbers begin with a “4”.
- Expenditure/Expense – a matching expenditure (governmental fund types) or expense (other fund types) is created at the same time as the related liability. Expenditure/expense account numbers begin with a “5”, except in the case of ID bills from internal service funds, which will begin with “6”.
- Other Financing Sources/Uses – transfers, bond proceeds and payments, distributions, and other related items that should not be included as Revenues or Expenditures in governmental fund types. Other Financing Sources/Uses account numbers begin with a “7”.

1.2.2 Fund Types

Within a government, funds are classified as Governmental, Proprietary and Fiduciary. Certain other units are established by state statute as Quasi-Agencies.

Governmental funds -- general fund, capital projects funds, debt service funds, permanent funds; monies which may be spent for operating, construction and debt payments. Permanent fund interest, but not principal, may be spent.

Proprietary funds -- internal service funds, enterprise funds -- internal service funds provide an at-cost service to the government; enterprise are self sufficient funds, provide service to citizens.

Fiduciary funds -- pension trust, private-purpose trust, agency funds -- monies not belonging to the government, but held in a fiduciary capacity.

Quasi-agencies -- established by statute to provide certain services to the government; these agencies have the option to, for the most part, establish their own operating rules and regulations.

1.2.3 Double entry accounting

The ENCOMPASS financial system utilizes “double entry accounting”. This means that for every Debit (+) entry there is an equal Credit (-) entry. For most transactions, the other side of the entry is automatically made by the system, assuming the correct equivalent entry is made by the user. If you are not familiar with these terms the following T diagram will help you to determine whether a Debit (+) or

Credit (-) entry should be entered in the system. Journal vouchers or journal entries (made directly to the general ledger) require knowledge of both sides of the transaction.

<u>DEBIT (DR +)</u>	<u>CREDIT (CR -)</u>
Cash in	Cash out
Asset (Billing of Receivables)	Receipts/revenues
Expenses/expenditures	Liability (Voucher Entry)
Reduction (refund) of revenue	Reduction (refund) of expenses/expenditures

As you will note from this table, if you are entering a receipt (4xxxxx), you would precede the dollar amount by a minus sign (-). If you are entering an expenditure/expense (5xxxxx), you would not need such an entry, as a plus sign (+) is defaulted.

1.3 ENCOMPASS FINANCIAL SYSTEM

On March 3, 2008, the State of Indiana implemented a statewide accounting system which was designed to provide a higher level of accountability to Hoosier taxpayers. This system, known as ENCOMPASS (Enterprise Common Processing and Analytics Systems) will pull together financial data from all agencies in a more consistent manner, this increasing the integrity of information statewide.

1.3.1 ENCOMPASS Chartfield Structure

Definitions of the major chartfields used in the ENCOMPASS financial system are:

- Business Unit -- the principal unit of financial accountability within State government.
- Fund (replaces fund center) -- the primary means within a Business Unit for tracking and relating specific sources and uses of revenues or budget authority. Funds are self balancing sets of accounting records. Each Business Unit will have at least one fund, however most will have multiple funds, one for each State appropriation, Federal Granting Agency, or other source of spending authority.
- Account Number (replaces object) -- used to classify specific transactions according to the nature of the receipt, expenditure or effect on the financial position of the fund or entity. See Appendices for listing of Account Numbers.
- Program -- a classification of an activity according to the purpose or objective of the activity. One initiative, PROBE, supported the identification of these activities and from the resulting report, Program values have been established. Program could be used to track other activities as well.
- Department -- signifies the department incurring a cost; relates to HR department values.
- Locality -- identifies a geographic location or area.
- Product -- used to track costs of goods or services provided to other State Agencies by Internal Service funds.

- Incident -- a transactional classification used to track costs associated with a particular event or activity, such as a hurricane or tornado, as determined by the Statewide Financial Policy Group.
- Project -- an accumulation of costs for a definite period of time. Project is required for all federal grants and all construction projects. Within the Project module, the following chartfields are available:
 - Activity -- Functional Activity ; Distributional Activity
 - Functional Activity -- assigned at the time the transaction is created to classify transactions for budgetary and/or reporting purposes.
 - Distributional Activity -- assigned in the Activity chartfield on the new transactional lines generated in the Project module when the original transaction undergoes Funds Distribution.
- Source Type -- provides State agencies with a chartfield to be utilized to meet their external and internal reporting needs not satisfied by the Activity chartfield.
 - Functional Source -- assigned at the time the transaction is created. The Functional Source Category chartfield provides State Agencies with a chartfield to be utilized to assist in properly recording time and labor in the Project Module.
 - Functional Source SubCategory -- assigned at the time the transaction is created. The Functional Source SubCategory chartfield provides State agencies with an additional chartfield to be utilized to assist in properly recording time and labor in the Project module in a lower level of detail than captured in the Functional Source Category.
 - Distributional Source Category -- assigned in the Source SubCategory chartfield on the new transactional lines generated in the Project module when the original transaction undergoes Funds Distribution. The Distributional Source Category will allow agencies to capture a lower level of detail related to a funding source than the level captured in Source Category.
- Analysis Type -- assigned to transactions within the Project module to communicate information related to the transaction such as the source of the transaction, what the transaction signifies and how the transaction should be treated within the Project module.

1.4 ACCOUNTING ENTRIES

If certain accounting entries are incorrect, the financial statements of the State of Indiana are at risk of reporting excessive revenues/expenditures. The following examples will help you to determine the correct entry, whether made to the originating module as a Journal Voucher (JV) in AP or in the general ledger (GL) as a Journal Entry.

- Journal Voucher (JV) – adjustment to transactions originating in AP module, subject to the following restrictions:
 - **Must be zero amount** – no dollar amounts changed, only accounting information
 - JV may be entered only for payments originating in the AP module
 - Timing not a factor; original voucher may be paid and posted

- Preferred if possible, as link to original is saved
- Journal Entry (JE) – an entry made to the general ledger (GL), used for the following:
 - Movement of expense/revenue to another agency
 - Change in dollar amount

1.4.1 Agency to Agency Sharing of Expenditures

Example: Agency 1 (500) has paid a \$10,000 bill for a consulting service which was shared with Agency 2 (505); Agency 2 used the service 20% of the time. The bill was paid from agency 500, fund 11410, account 531010. A change in the distribution of the \$\$ amount will result, so a Journal Entry to the GL is necessary.

The Journal Entry to charge \$2,000 (\$10,000 X .20) to Agency 2 would be made as an Inter Unit transaction in the GL as follows:

Agency (BU)	Fund	Account	DR (+)	CR (-)
500	11410	531010		2,000
505	16640	531010	2,000	

The expenditure for Agency 1 has been reduced by \$2,000; the expenditure for Agency 2 has been increased. After both agencies have approved the transaction, it would route to the AOS for posting to the GL.

1.4.2 Allocation of Expense to Federal Fund (within agency)

Example: Agency 1 has purchased, and paid for from their general fund (11410), software costing \$15,000, using account 555553. Based on a grant from the federal government, 50% of the cost is reimbursable by the grant, which is accounted for in fund 62130, Project #500MED08.

A change in the distribution of the \$\$ amount will result, so a Journal Entry to the GL is necessary. The Journal Entry to GL to charge \$7,500 to the federal grant is made as follows. We simply move the expenditure from the general fund to the federal project within the federal fund.

Agency (BU)	Fund	Account	Project	DR(+)	CR(-)
500	11410	555553	N/A		\$7,500
500	62130	555553	500MED08	\$7,500	

A similar entry is made to allocate salary/admin costs to the federal fund if initially paid from a state fund. When the reimbursement is received from the federal government, the grant revenue is credited (-), as this is additional cash received by the state. After the agency has approved the transaction, it is routed to AOS for approval and posting.

1.4.3 Passing Federal Dollars to Sub-recipient – Sub-recipient is Another State Agency or Another Federal Program

Example: Federal Program 1 has received \$1,000,000 from the related federal agency. The amount of \$500,000 is to be transferred to either another State agency or another federal program. The originating project ID must be used by the recipient agency/program in order to trace the federal dollars (change the BU only). Again, both agencies must approve the entry before it is routed to the AOS for posting.

Agency (BU)	Fund	Account	Project	DR(+)	CR(-)
500	62130	441000	500MED08	\$500.000	

498	62130	441000	498MED08	\$500,000
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Note: With all of the above transactions, we have simply moved the revenue/expenditure from one fund/account to another. We have not increased (or decreased) the total revenue/expenditures of the state.

1.4.4 Passing Federal Dollars to Outside Sub-recipient

Outside entity is a local unit of government, not-for-profit, or quasi-state agency.

*Example 1 -- Agency 1 remits \$500,000 from a **reimbursable** federal grant to Good County; the distribution would be an expense of the grant project at the State level and revenue to the county. Grant revenue is credited when the reimbursement is received from the federal government.*

Agency	Fund	Account	Project	DR(+)	CR(-)
<i>Distribution to outside unit:</i>					
500	62130	580190	500MED08	\$500,000	
500	62130	110000 (CASH)	500MED08		\$500,000

Receipt of federal reimbursement:

500	62130	110000(CASH)	500MED08	\$500,000	
500	62130	441000	500MED08		\$500,000

*Example 2 -- Agency 1 remits \$500,000 from an **advance** federal grant to Good County; the distribution, also an advance, would be a prepaid expense (+) of the grant project at the State level and a revenue to the county. As expenses are accounted for, the prepaid amount would be moved to an expense(+).*

Agency	Fund	Account	Project	DR(+)	CR(-)
<i>Advance to outside unit:</i>					
500	62130	191000	500MED08	\$500,000	
500	62130	110000 (CASH)	500MED08		\$500,000

Movement of prepaid expense to expense:

500	62130	580235	500MED08	\$500,000	
500	62130	191000	500MED08		\$500,000

1.4.5 Payments to Fiduciary Funds/Quasi-Agencies/Component Units from Governmental Funds

State of Indiana Fiduciary Funds include PERF, TRF, State Police Pension, Child Support Fund and various payroll related funds. Quasi Agencies/Component Units include PERF, TRF, BMVC, IEDC IFA, IN Bond Bank, and State Lottery Commission.

A payment to these units is an expenditure of the state and revenue to the fiduciary or quasi unit and should be processed as any other payment to an outside vendor. Likewise, a payment from a fiduciary or quasi would be an expense of the fiduciary/quasi and revenue to the state.

1.4.6 ID Bills for Products/Services Rendered

ID billings should be used ONLY by certain internal service funds billing a product or service to another business unit. These internal service funds include Office of Information Technology (OIT), Motor Pool, and various self insurance funds.

An ID bill will be processed by the internal service fund, debiting (+) the expense account 65xxxx for the business unit being billed and crediting (-) the revenue account 64xxxx in the internal service fund. No Inter Unit approval is necessary. These ID bills will be initiated in GL and routed directly to the AOS for approval and posting. If the business unit billed discovers an error or has a complaint, a grievance should be filed with the internal service fund.

1.4.7 PEN Products Purchases

All purchases from PEN Products should be processed through ePro and paid through Accounts Payable. Accounts beginning with "6" will be used for these transactions also.

1.4.8 Memo of Understanding (MOU) Between Agencies

A Memo of Understanding (MOU) may be created and approved by the State Budget Agency, as allowed by Financial Management Circular #2007-6, for the purpose of two or more State agencies to share goods or services.

Example: Agency 1 (080) has an approved MOU with Agency 2 (050) to provide certain audit services not otherwise required by law. In accordance with the MOU, salaries of auditors for time spent on this project totaled \$5,000. Keeping in mind that we do not want to overstate revenues or expenditures for the state as a whole, the following accounting entries could be made on a Journal Entry to the GL. Since it is not directly related to an AP transaction, it would not be entered in AP as a JV.

Agency(BU)	Fund	Account	Department	DR(+)	CR(-)
080	10750	511002	AUD		\$5,000
050	10470	511002	AUD	5,000	

1.4.9 Movement of State Funds to Federal Funds

State appropriations will initially be recorded in a state legal fund which is established by state statute.

Example: Agency 1 is required to provide a state match in the amount of \$500,000 for a federal grant, which is accounted for in fund 62130, project #500MED08. Appropriations/allotments have been recorded in fund 11410; \$500,000 must be moved to the federal project. Using transfer in/out accounts, the amount is moved, retaining the original revenue in the state legal fund.

Agency(BU)	Fund	Account	Project	DR(+)	CR(-)
500	62130	740110	500MED08	\$500,000	
500	11410	750115			\$500,000

1.5 APPENDICES

1.5.1 Account Number Listing

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